

REPORT ON EXAMINATION

of the

**PARATRANSIT INSURANCE COMPANY, a
MUTUAL RISK RETENTION GROUP**

MEMPHIS, TN

RECEIVED

MAR 08 2004

Dept. Of Commerce & Insurance
Company Examinations

as of

DECEMBER 31, 2002

DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

EXHIBIT

tabbles

A

TABLE OF CONTENTS

<u>Item</u>	<u>Page</u>
Salutation.....	one
Introduction.....	1
Scope of Examination.....	1
Company History (includes exhibit of growth and financial history)	2
Charter and Bylaws	4
Management and Control	5
Corporate Records	7
Fidelity Bond and Other Insurance	8
Territory (includes inforce/premium by state).....	8
Plan of Operation.....	9
Market Conduct Activities	9
Reinsurance	10
Retirement Plan and Other Employee Benefits	12
Loss Experience	13
Accounts and Records.....	13
Statutory Deposits	14
Agreements with Parent, Subsidiaries and Affiliates	14
Pecuniary Interest Tenn. Code Ann. § 56-3-103	15
Commission Equity.....	15
Dividends or Distributions.....	15
Litigation	15
Subsequent Events	15
Financial Statement.....	16
Analysis of Changes in Financial Statement and Comments Resulting from Examination.....	21
Comments and Recommendations	23
Conclusion.....	25
Affidavit.....	26

Memphis, Tennessee
March 8, 2004

Honorable Paula A. Flowers
Commissioner
State of Tennessee
Department of Commerce and Insurance
Nashville, Tennessee 37243

Dear Commissioner:

Pursuant to your instructions and in accordance with Tennessee insurance laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination and market conduct review was made of the condition and affairs of the

**PARATRANSIT INSURANCE COMPANY, a
MUTUAL RISK RETENTION GROUP
MEMPHIS, TENNESSEE**

hereinafter and generally referred to as the Company, and a report thereon is submitted as follows:

INTRODUCTION

This examination was called by the Commissioner of Commerce and Insurance of the State of Tennessee and commenced on April 14, 2003. The examination was conducted under the association plan of the NAIC by duly authorized representatives of "The Department of Commerce and Insurance", State of Tennessee.

SCOPE OF EXAMINATION

This examination report covers the period from December 31, 1997, the date of the last previous examination, to the close of business on December 31, 2002, and includes any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

The examination of the financial condition was conducted in accordance with guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) Examiners Handbook. During the course of examination, assets were verified and valued and liabilities were determined and estimated as of December 31, 2002. The financial condition of the Company and its amount of solvency were thereby established. Test checks were made of income and disbursement items for selected

periods, and a general review was made of the Company's operations, practices, and compliance with applicable statutes and regulations. All asset and liability items contained in the financial statement of this report were examined and verified with relative emphasis according to their amount and potential impact on capital and surplus.

In addition, the following topics were reviewed:

- Company History
- Charter and Bylaws
- Management and Control
- Corporate Records
- Fidelity Bonds and Other Insurance
- Territory (includes inforce/premium by state)
- Plan of Operation
- Market Conduct Activities
- Reinsurance
- Retirement Plan and Other Employee Benefits
- Loss Experience
- Accounts and Records
- Statutory Deposits
- Agreements with Parent, Subsidiaries and Affiliates
- Pecuniary Interest
- Commission Equity
- Dividends or Distribution
- Litigation
- Subsequent Events
- Financial Statement

The previous examination was conducted as of December 31, 1997 by authorized representatives of "The Department of Commerce and Insurance", State of Tennessee. The last previous examination resulted in a \$33,089 decrease in surplus due to the non-admitting of Federal Income Tax Recoverable in the same amount based on Tenn. Code Ann. § 56-1-405. The examination report made a recommendation that the Company amend its charter to change the Company name to include the word "mutual" as required by Tenn. Code Ann. § 56-19-102. An additional comment was included stating the Company had no conflict of interest policy for its directors.

The Company subsequently amended its charter and changed its name to include the word "mutual". Presently, its directors complete annual conflict of interest statements.

COMPANY HISTORY

The Company was incorporated on June 3, 1987, as a mutual property and casualty insurer under Article 48A, Subtitle 46, Annotated Code of Maryland, with the name

Paratransit Risk Retention Group of Maryland, Inc., and commenced business on March 1, 1988. The Company was organized for the purpose of providing vehicle liability insurance to its member public transportation fleet companies. On March 4, 1988, the Company assumed the net assets of Paratransit Insurance Company, Ltd. (PIC); an insurance company incorporated on March 1, 1986, under the laws of the Cayman Islands, British West Indies. The members of PIC became members of the Company with the subscribers' capital account being transferred to the Company. PIC ceased to have separate existence after the transfer. In conjunction with the transfer of business from PIC, the Company assumed the runoff of unpaid losses on all business written by PIC prior to March 1, 1988.

On January 4, 1993, the Company formed a wholly-owned subsidiary, Public Auto Claims Services, Inc., to provide claims administrative services. The subsidiary remained substantially dormant from its inception. In 1996, the subsidiary was liquidated and its assets were transferred to the Company. The net amount received was \$10,866. In 1997, the subsidiary was dissolved.

In January 1995, the Company contributed \$750,000 as initial capital to its wholly-owned subsidiary, Paratransit Risk Retention Group Insurance Company, a property and casualty insurance company domiciled in Kansas. The Kansas subsidiary was chartered for the purpose of redomesticating the Company from Maryland to Kansas. In 1996, the corporate charter of this subsidiary was surrendered and all of its assets were transferred to the Company. The net amount received by the Company was \$813,516. During its existence, there were no insurance policies issued by the Kansas subsidiary.

The Company applied for redomestication from Maryland to Tennessee during 1996. On December 30, 1997, the Company was chartered in Tennessee as Paratransit Risk Retention Group Insurance Company. The Company was issued a certificate of authority dated April 20, 1998 from The Department of Commerce and Insurance of the State of Tennessee to transact the business of casualty insurance (commercial auto liability only). The Company's principal place of business is 1000 Ridgeway Loop Road, Memphis, Tennessee which is the address of Marsh USA Inc. the registered agent for the Company. Marsh had acquired Sedgwick James of Tennessee, Inc. the former registered agent for the Company effective December 31, 1998.

The Company's members consented on September 10, 1999 pursuant to Tenn. Code Ann. § 48-17-104 to change the name of the Company to Paratransit Insurance Company, a Mutual Risk Retention Group. A new certificate of authority in said name was issued by The Department of Commerce and Insurance of the State of Tennessee on February 2, 2000.

At December 31, 2002, the Company was licensed in one state, Tennessee.

The following exhibit depicts certain aspects of the growth and financial history of the Company since the previous examination, based upon the annual statements filed with "The Department of Commerce and Insurance", State of Tennessee.

<u>Date</u>	<u>Earned Premiums</u>	<u>Incurred Losses & LAE</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus and Unassigned Funds</u>
12/31/98	\$1,519,797	\$1,367,817	\$11,731,681	\$8,917,296	\$2,814,385
12/31/99	1,667,727	1,502,677	12,231,859	9,343,001	2,888,858
12/31/2000	1,522,208	1,390,676	13,052,515	9,674,120	3,378,395
12/31/2001	2,063,099	1,427,570	14,437,916	10,783,236	3,654,680
12/31/2002	2,228,576	533,145	15,151,471	10,976,448	4,175,023

CHARTER AND BYLAWS

Charter:

The restated Charter approved by the board of directors on August 27, 1999 and approved by the members on September 10, 1999, changed the Company's name from Paratransit Risk Retention Group Insurance Company to Paratransit Insurance Company, a Mutual Risk Retention Group. The charter establishes the Company as a mutual insurer and states the purposes for which the Company is formed as follows:

- (a) to undertake and carry on the business of insurance, limited to liability insurance for assuming and spreading all or any portion of similar or related liability exposures of members;
- (b) to do any and all things permitted under Tennessee law pertaining to a mutual insurance company; and
- (c) to do any and all things permitted under federal and state law pertaining to a risk retention group, as those laws are amended from time to time.

The charter establishes that the membership of the Company shall consist of persons, firms or corporations who have been issued a policy of insurance by the Company, which is in full force and effect. Membership shall cease when such insurance is canceled or terminated for any cause whatsoever. Additionally, the charter recites other general and specific powers in detail. These are usual in nature and consistent with statute.

Bylaws:

The bylaws of the Company in effect at December 31, 2002 were last amended on December 9, 1999. The bylaws are such as those generally found in corporations of this type and contain no unusual provisions.

The bylaws of the Company provide that all corporate powers are vested in and shall be exercised by a Board of Directors except as otherwise prescribed by statute or by the Company's charter. The Board of Directors shall consist of not less than seven (7) or more than twelve (12) directors. The directors are elected at the annual meeting of the members and hold office until their successors have been duly elected and qualified. Regular meetings of the Board of Directors are held on such dates as the Board may designate. Special meetings may be called by the Secretary at the request of the President or of any two (2) directors. The Board may hold its meetings at such place as the Board may from time to time determine, but until the Board otherwise determines, the meetings may be held at such place or places as the President may from time to time determine. A majority of the directors shall constitute a quorum at all meetings of the Board of Directors. Unless otherwise provided by law, any action required to be taken at a meeting of the directors or any other action which may be taken at a meeting of the directors may be taken without a meeting if a consent in writing, setting forth the action so taken, is signed by all of the directors. A resignation from the Board of Directors shall be deemed to take effect upon the acceptance by the Board unless otherwise specified therein. Such vacancy may be filled by the Board by a vote of the majority of the remaining directors. At any meeting of members duly called for the purpose, any director may, by the vote of a majority of all of the members be removed from office and another be appointed in the place of the person so removed. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of two (2) or more directors of the Company, which, to the extent provided in the resolution, shall have and may exercise the powers of the Board of Directors.

MANAGEMENT AND CONTROL**Management:**

The Company's bylaws state that the business affairs of the Company shall be under the direction and control of a Board of Directors consisting of not less than seven (7) or more than twelve (12) directors. As of December 31, 2002, the Board of Directors of the Company was composed of the following:

Steven Joseph Abraham
Richard George Corey
William Hamilton Smythe, III
Judith O. Swystun

Jeffrey Lee Mackin
Randy Schultz
Darrell Fisher

The following Directors were serving on the Executive Committee at December 31, 2002:

William Hamilton Smythe, III
Richard George Corey
Judith O. Swystun
Jeffrey Lee Mackin

In addition to the Executive Committee, the following committees and their members at December 31, 2002 were as follows:

Audit Committee

Steven Joseph Abraham
Jeffrey Lee Mackin
Judith O. Swystun

Claims Committee

Jeffrey Lee Mackin
Judith O. Swystun

Investment Committee

William Hamilton Smythe, III
Judith O. Swystun
Richard George Corey

Marketing Committee

Richard George Corey
Steven Joseph Abraham

Underwriting Committee

Richard George Corey
Steven Joseph Abraham
William Hamilton Smythe, III

As of December 31, 2002, the following persons held office in the Company:

William Hamilton Smythe, III, President
Jeffrey Lee Mackin, Secretary
Judith O. Swystun, Treasurer
Andrew Sargeant, Assistant Treasurer
Mark Forrester, Assistant Secretary
Richard George Corey, Vice President

The administrative functions of the Company are performed by the office staff of Marsh USA Inc. under recitals of a service agreement. The statutory accounting functions for the Company are performed by USA Risk Group of Vermont under recitals of a captive insurance company services agreement. These respective agreements are outlined under the caption "Agreements with Parent, Subsidiaries and Affiliates". Certain services are purchased from outside contractors if needed and are not available from in house personnel. Such services include actuarial analysis and independent audit.

Actuarial Services:

Select Actuarial Services
700 Craighead Street, Suite 303
Nashville, TN 37204

Auditing Services:

Faulkner, Mackie & Cochran, P.C.
Suite 200, One Belle Meade Place
4400 Harding Road
Nashville, TN 37205

Control:

Primary control of the Company is vested in its members. The membership of the Company consists of persons or entities who have been issued a policy of insurance by the Company. Annual meetings of the members of the Company are held each year at such place, date and time as the Board of Directors may determine. The time and date of said meetings shall be no later than April 30th of each year, for the purpose of electing directors and for the transaction of such other business as may lawfully be brought before the meeting. Special meetings of the members may be called by the Secretary upon written request of the President or by any two (2) directors. Upon request in writing signed by 20 percent of the Members delivered to the President, Secretary or any Director, it shall be the duty of the President, Secretary or such Director to call forthwith a meeting of Members. The presence in person or by proxy of a majority of the members shall be requisite to constitute a quorum at any meeting of Members, but less than such a quorum may adjourn the meeting from time to time, and at any adjourned meeting, any business may be transacted which might have been transacted if the meeting had been held as originally called. Each Member entitled to vote in accordance with the terms and provisions of the Company's charter and bylaws is entitled to one (1) vote, in person or by proxy, for each insurance policy held by such Member.

The Company's Directors file annual conflict of interest statements. The statements were reviewed and found to be in compliance with Tenn. Code Ann. § 56-3-103.

CORPORATE RECORDS

Minutes of meetings of the shareholders and Board of Directors of the Company were reviewed for the period under examination. In general, such minutes appear to be in proper order and accurately report the proceedings of each respective meeting.

FIDELITY BOND AND OTHER INSURANCE

The following is a schedule of insurance maintained by the Company at December 31, 2002.

<u>Type of Coverage</u>	<u>Coverage Limits</u>
Executive Liability and Indemnification	\$1,000,000
	(\$25,000 deductible, executive indemnification)

Coverage is underwritten by Federal Insurance Company, Indianapolis, IN which is licensed in Tennessee as a "Foreign Property and Casualty Insurer"

The Company's fidelity bond coverage exceeds the \$150,000 to \$175,000 suggested minimum as exhibited in the NAIC Financial Condition Examiners Handbook.

TERRITORY

As of December 31, 2002, and as of the date of this examination report, the Company was licensed to transact business in the State of Tennessee. The Certificate of Authority for that jurisdiction was reviewed. The Company is authorized to conduct business in other states pursuant to the federal "Liability Risk Retention Act of 1986". As of December 31, 2002 and as of the date of this examination report, the Company was registered in a total of thirty-two (32) states.

During 2002, the Company wrote direct premium in fifteen (15) states:

<u>State</u>	<u>Amount</u>
Alabama	\$119,342
Connecticut	495,368
Iowa	163,847
Kentucky	301,746
Missouri	541,004
Nebraska	201,280
New Mexico	239,667
North Carolina	49,490
Ohio	482,058
Oklahoma	274,930
South Carolina	57,761
Tennessee	101,467
Utah	327,657
Virginia	236,361
West Virginia	<u>81,319</u>
Total	\$3,673,297

PLAN OF OPERATION

The Company writes commercial automobile liability coverage for transportation fleets of fifteen (15) units or more, mainly taxi cab fleets but also including limousines, buses and care-a-vans. All policies are issued on a twelve (12) month non-assessable basis to members. As part of the underwriting process, the Company and the subscribing member mutually agree on the portion of each loss to be retained by the member. This self-insured retention may range from \$10,000 to \$200,000. In addition to the premium charged, the Company assesses a membership capital contribution fee to each insured. This membership fee is based on the number of vehicles the member is insuring and is recorded as paid in surplus. Currently, the rate is forty dollars, \$40 per vehicle. Premiums and memberships fees are payable in four (4) equal installments.

Policy preparation is performed by Marsh USA Inc. under recitals of a services agreement with the Company and is subject to the underwriting rules adopted by the Company and promulgated in accordance with approved rates. Prospects are discussed with the Underwriting Committee prior to quoting, and on site visits are made whenever possible.

The largest net amount insured by the Company during 2002 was \$100,000 less the individual policyholder's self-insured retention. In some states, the Department of Motor Vehicles requires that the Company provide a "First Dollar Endorsement" to guarantee the insured's payment of any self-insured retention. The Company still expects to collect the self-insured retention (SIR) from the insured and therefore, usually requires the insured to post collateral to cover the SIR. This is typically in the form of a letter of credit.

The adjustment of claims is handled by the individual insured member. Under provisions of each member's policy, "the Named Insured warrants they have either a full-time Claims Department or have contracted with a reputable claims handling firm for the handling of all claims." "The Named Insured further warrants they have a working relationship with a reputable attorney for handling the defense of all claims." The Named Insured must additionally maintain a daily log of all claims occurring within the retained limit, including a description of each claim. Reports are submitted to the Company quarterly. "Settlement in excess of the retained limit may not be made without the written approval of the Company pursuant to language in the Named Insured's policy."

MARKET CONDUCT ACTIVITIES

In accordance with the policy of the Department of Commerce and Insurance, State of Tennessee, a market conduct review was made of the Company as of December 31, 2002 in conjunction with this examination. The following items were addressed:

Policy Forms, Rating and Underwriting:

Under Tenn. Code Ann. § 56-5-306, rates, supplementary rate information, policy forms and endorsements will be filed with the Commissioner not later than fifteen (15) days after the effective date. Prior approval is not required. The Company uses casualty rates developed by a combination of Company experience and industry data. Policies written were reviewed to application files and underwriting standards.

The Company maintains written underwriting procedures and rating guide. A physical inspection of the account is completed by either a Director, an approved member of Paratransit or Marsh USA Inc.

Advertising:

The Company maintains an advertising file. The advertising program consists of a Company website (www.paratransitinsurance.com) and printed advertisements in trade publications. The advertising file was reviewed and appears to be in compliance with applicable statutes and regulations.

Claims Review:

A sample of open and closed claim files reviewed during the examination indicated that claims were being paid in accordance with policy provisions and settlements were made promptly upon receipt of proper evidence of the Company's liability.

Policyholder Complaints:

Inquiries made to the various policyholders' service offices indicated no regulatory concerns with the Company during the period under examination. No unusual practices or items warranting criticism of the Company were noted.

REINSURANCE

The Company's reinsurance agreements were reviewed and found to contain the standard provisions for arbitration, cancellation, errors and omissions, exclusions, insolvency, offset, settlement, taxes and termination. The following is a summary of the reinsurance agreements in effect as of December 31, 2002:

Ceded:

(1)

<u>Type:</u>	First Excess of Loss (treaty basis)
<u>Reinsurer:</u>	SCOR Reinsurance Company
<u>Term:</u>	July 1, 2002 through June 30, 2003

Premium: 27.6% of net written premium, subject to a minimum of \$814,000 (or pro rata portion thereof if term of contract is less than 12 months) with a deposit premium of \$1,017,916 payable in four quarterly payments of \$254,479 each

Commission: n/a

Coverage: Excess of the greater of the insured's self-insured retention or the first \$100,000 of ultimate net loss on each occurrence not to exceed \$400,000 as respects any one occurrence

"In the event the Company suffers losses arising out of the same occurrence under two or more separate policies which have been allocated to this Contract and to another contract, the Company's retention with respect to this Contract shall be reduced to that percentage of the Company's retention which the Company's losses under policies allocated to this Contract bear to the Company's total losses arising out of that occurrence. The limit of the Reinsurer's liability shall be prorated in the same manner."

Intermediary: Benfield Blanch Inc.

SCOR Reinsurance Company is licensed in Tennessee as a "Foreign Property and Casualty Insurer". The contract does not require approval pursuant to Tenn. Code Ann.

(2)

Type: Second Excess of Loss (treaty basis)

Reinsurer: SCOR Reinsurance Company

Term: July 1, 2002 through June 30, 2003

Premium: 5% of net written premium, subject to a minimum of \$147,500 (or pro rata portion thereof if term of contract is less than 12 months) with a deposit premium of \$184,400 payable in four quarterly payments of \$46,100 each

Commission: n/a

Coverage: Excess of the greater of the insured's self-insured retention or the first \$500,000 of ultimate net loss on each occurrence not to exceed \$500,000 as respects any one occurrence

"The Company shall be permitted to carry underlying excess of loss reinsurance, recoveries under which shall inure solely to the benefit of the Company and be entirely disregarded in applying all of the provisions of this Contract."

"In the event the Company suffers losses arising out of the same occurrence under two or more separate policies which have been allocated to this Contract and to another contract, the Company's retention with respect to this Contract shall be reduced to that percentage of the Company's retention which the Company's

losses under policies allocated to this Contract bear to the Company's total losses arising out of that occurrence. The limit of the Reinsurer's liability shall be prorated in the same manner."

Intermediary:

Benfield Blanch, Inc.

SCOR Reinsurance Company is licensed in Tennessee as a "Foreign Property and Casualty Insurer". The contract does not require approval pursuant to Tenn. Code Ann.

(3)

Type:

Excess Casualty Clash (treaty basis)

Reinsurer:

SCOR Reinsurance Company

Term:

October 1, 2002 through June 30, 2003

Premium:

2.4% of net earned premium with a deposit premium of \$66,375 payable in three payments of \$22,125 each on October 1, 2002 and January 1 and April 1, 2003

Commission:

n/a

Coverage:

Excess of \$1,000,000 of ultimate net loss on each occurrence not to exceed \$1,000,000 as respects any one occurrence

Intermediary:

Benfield Blanch, Inc.

SCOR Reinsurance Company is licensed in Tennessee as a "Foreign Property and Casualty Insurer". The contract does not require approval pursuant to Tenn. Code Ann.

The Company enters into facultative reinsurance arrangements on risks over one million dollars, \$1,000,000. These risks are reinsured with Continental Casualty Company which is licensed in Tennessee as a "Foreign Property Casualty Insurer". These contracts do not require approval pursuant to Tenn. Code Ann.

RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

The Company has no employees. All administrative services are performed by Marsh USA Inc. (Marsh) as outlined in an agreement between the Company and Marsh. The said agreement is outlined under the caption "Agreements with Parent, Subsidiaries and Affiliates".

LOSS EXPERIENCE

<u>Year</u>	<u>Losses Incurred</u>	<u>LAE Incurred</u>	<u>Premiums Earned</u>	<u>Loss Ratio</u>
1998	\$1,077,159	\$290,658	\$1,519,797	90%
1999	1,349,349	153,328	1,667,727	90.1%
2000	1,195,945	194,731	1,522,208	91.4%
2001	1,203,017	224,553	2,063,099	69.2%
2002	<u>700,360</u>	<u>(167,215)</u>	<u>2,228,576</u>	23.9%
Total	\$5,525,830	\$696,055	\$9,001,407	69.1%

ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including substantial verification of postings, extensions and footings and reconciliation of subsidiary ledgers to control accounts where necessary. General ledger trial balances were reconciled with copies of annual statements for the years 1998, 1999, 2000, 2001 and 2002.

Accounting records conform to generally accepted insurance accounting practices and appear to properly reflect the operations during the period under examination and the status of the Company at the date of examination.

The Company's Risk Based Capital Report was reviewed.

An annual audit of the Company is performed by an independent accounting firm, Faulkner, Mackie & Cochran, P.C.

Books and records of the Company are kept at the home office location:

Marsh USA Inc.
1001 Ridgeway Loop
Memphis, TN 38104

Additional location of books and records used in preparation of financial reporting statements:

Vermont Insurance Management, Inc.
P. O. Box 306
Montpelier, VT 05601

STATUTORY DEPOSITS

In compliance with statutory requirements, the Company maintained the following deposits at December 31, 2002.

<u>Where Deposited and Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Tennessee			
FHLB 5.04% due 10/25/06	\$100,000	\$100,633	\$100,633
Total special deposits held for the benefit of all policyholders of the Company	<u>100,000</u>	<u>100,633</u>	<u>100,633</u>
Total	<u>\$100,000</u>	<u>\$100,633</u>	<u>\$100,633</u>

The Schedule D of the Company's annual statement lists the above security as a FNMA rather than a FHLB; however, the CUSIP # and other information are correctly recorded. The above deposit was confirmed with the custodian at "The Division of Insurance".

AGREEMENTS WITH PARENT, SUBSIDIARIES AND AFFILIATES

The Company is a stand alone Mutual Risk Retention Group and is not part of a holding company system. Administrative services are performed by Marsh USA Inc. under recitals of a service agreement for the term beginning July 1, 2000 and continuing through July 1, 2003. Statutory accounting services are performed by USA Risk Group of Vermont under recitals of a captive insurance company service agreement dated April 1, 1999.

Marsh USA, Inc. receives a fee of 18% of Gross Written Premium for the period of July 1, 2002 – July 1, 2003. The % fee is subject to a reduction of .5% for every \$500,000 in premium growth or fraction thereof. The percentages are adjusted at each anniversary.

USA Risk Group of Vermont receives a fee of \$60,000 per annum payable quarterly in advance. Additionally, USA Risk Group receives reasonable software and printing costs associated with preparation of annual and quarterly statements as well as costs for unanticipated expenses for services not specifically included in the agreement. Discussion of reasonable cost and expenses is included in the Compensation Section of the said agreement.

These agreements are not required to be filed with "The Division of Insurance". The Company does not meet the definitions of Tenn. Code Ann. § 56-11-201 and therefore;

would not file management agreements and service contracts pursuant to Tenn. Code Ann. § 56-11-206.

PECUNIARY INTEREST TENN. CODE Ann. § 56-3-103

The Company is a stand alone Mutual Risk Retention Group owned by its membership and is not part of a holding company system. The Company's Directors file annual conflict of interest statements. The statements were reviewed and found to be in compliance with Tenn. Code Ann. § 56-3-103.

COMMISSION EQUITY

The reinsurance agreements which the Company had in place as of December 31, 2002 do not contain provisions for a ceding commission to the Company. Therefore; no commission equity exists in the ceded unearned premium.

DIVIDENDS OR DISTRIBUTIONS

Dividends to policyholders paid by the Company are from surplus profits and are therefore in compliance with Tenn. Code Ann. § 56-3-108. The Company is not required to notify "The Department of Commerce and Insurance" of dividends to policyholders or seek approval due to the reporting requirement for all dividends and other distributions to shareholders being subject to Tenn. Code Ann. § 56-11-206(b). The Company does not meet the definition of a holding company defined by Tenn. Code Ann. § 56-11-201.

LITIGATION

As of December 31, 2002, the Company had no pending litigation, other than that arising out of the normal course of business, which would adversely affect the financial condition of the Company.

SUBSEQUENT EVENTS

During 2003, the Company renegotiated its reinsurance arrangement with Swiss Reinsurance America Corporation rather than SCOR Reinsurance Company. This was due to a lowering of the A. M. Best rating of SCOR Re during 2002. The major difference is that the Company will now retain the first \$250,000 each accident less the insured self insured retention. Swiss Reinsurance America Corporation is licensed in Tennessee as a "Foreign Property and Casualty Insurer".

FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of income at December 31, 2002, together with a reconciliation of capital and surplus for the period under review, as established by this examination:

ASSETS

	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$9,383,408			\$9,383,408
Preferred Stocks	202,400			202,400
Common Stocks	2,020,393			2,020,393
Cash and short-term investments	1,008,621			1,008,621
Premiums and agents, balances in course of collection	8,314		8,314	0
Premiums, agent balances, and installments booked but deferred and not yet due	1,861,010			1,861,010
Reinsurance recoverables on loss and loss adjustment expenses	327,813			327,813
Federal and foreign income tax recoverable and interest thereon	469,635		274,430	195,205
Interest, dividends and real estate income due and accrued	145,994			145,994
Other non-admitted assets	0			0
Aggregate write-ins for other than invested Assets	<u>415,298</u>	_____	<u>408,671</u>	<u>6,627</u>
Totals	<u>\$15,842,886</u>	<u>\$0</u>	<u>\$691,415</u>	<u>\$15,151,471</u>

LIABILITIES, SURPLUS, AND OTHER FUNDS

Losses	\$8,111,363
Reinsurance payable on paid loss and loss adjustment expenses	0
Loss adjustment expenses	265,743
Commissions payable, contingent commissions and other similar charges	0
Other expenses (excluding taxes, licenses and fees)	22,978
Taxes, licenses and fees (excluding federal and foreign income tax)	121,824
Federal and foreign income taxes	78,078
Unearned premiums	1,582,493
Advance premiums	15,449
Dividends declared and unpaid: policyholders	503,953
Ceded reinsurance premiums payable (net of ceding commissions)	141,820
Amounts withheld or retained by company for account of others	<u>132,747</u>
Total Liabilities	10,976,448
Aggregate write-ins for special surplus funds	2,367,069
Gross paid in and contributed surplus	650,289
Unassigned funds (surplus)	<u>1,157,665</u>
Surplus as regards policyholders	4,175,023
Total liabilities and surplus	<u>\$15,151,471</u>

STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	\$2,228,576
Deductions: Losses incurred	\$700,360
Loss expenses incurred	(167,215)
Other underwriting expenses incurred	<u>764,422</u>
Total underwriting deductions	<u>1,297,567</u>
Net underwriting gain	931,009

INVESTMENT INCOME

Net investment income earned	517,921
Net realized capital gains (losses)	<u>(126,292)</u>
Net investment gain	391,629

OTHER INCOME

Aggregate write-ins for miscellaneous income	<u>50,000</u>
Net income before dividends to policyholders and before federal income taxes	1,372,638
Dividends to policyholders	500,000
Federal income taxes incurred	<u>343,983</u>
Net income	<u>\$528,655</u>

CAPITAL AND SURPLUS

Surplus as regards policyholders, December 31 prior year	\$3,654,680
Net income	\$528,655
Net unrealized capital gains (losses)	(114,867)
Change in net deferred income tax	24,906
Change in non-admitted assets	(42,637)
Cumulative effect of changes in accounting principles	0
Surplus adjustments: Paid in	124,286
Change in surplus as regards policyholders for the year	<u>520,343</u>
Surplus as regards policyholders, December 31 current year	<u>\$4,175,023</u>

RECONCILIATION OF CAPITAL AND SURPLUS
FOR THE PERIOD UNDER EXAMINATION

Surplus as regards policyholders December 31	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Previous Year	<u>\$2,648,952</u>	<u>\$2,814,386</u>	<u>\$2,888,859</u>	<u>\$3,378,395</u>	<u>\$3,654,680</u>
Net Income	19,054	49,450	34,794	138,900	528,655
Net unrealized capital gains or (losses)	105,861	257,816	(24,714)	(95,386)	(114,867)
Change in net deferred income tax	0	0	0	40,493	24,906
Change in non-admitted Assets	(119,689)	28,758	(15,693)	(100,071)	(42,637)
Change in provision for Reinsurance	11,806	(391,438)	394,000	15,000	0
Cumulative effect of changes in accounting principles	0	0	0	165,909	0
Surplus adjustments: Paid in	148,402	101,516	117,640	111,440	124,286
Aggregate write-ins for gains and losses in surplus	<u>0</u>	<u>28,371</u>	<u>(16,491)</u>	<u>0</u>	<u>0</u>
Surplus as regards to policyholders December 31					
Current Year	<u>\$2,814,386</u>	<u>\$2,888,859</u>	<u>\$3,378,395</u>	<u>\$3,654,680</u>	<u>\$4,175,023</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS
RESULTING FROM EXAMINATION

Differences in various items were noted during the course of examination; however, none were considered to produce a material effect on surplus funds, as regards policyholders, either singly or in aggregate.

**SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES
IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM
EXAMINATION" AS THEY AFFECT SURPLUS**

No schedule or comment applicable. All noted differences were well below the tolerable error established for examination purposes.

COMMENTS AND RECOMMENDATIONS

Comments:

- Review of various issued checks during the testing of various items indicated that there were instances when the Company was not adhering to its policy of having two signatures required on checks over \$50,000. It is suggested that the Company effect more efficient controls to insure that two signatures are on checks which are \$50,000 or more. This finding was also noted in the CPA Management Letter.
- During the examination it was determined, that the charter and the bylaws of the Company were not in agreement as to the minimum number of directors. The Amended and Restated Charter stated that "directors shall never be less than nine (9)" and the bylaws called for not less than seven directors. Articles of Amendment to the Charter were adopted May 21, 2003 to state "The number of Directors of the Corporation shall be not less than seven (7) or more than twelve (12)." "The number of Directors may be increased or decreased pursuant to the Bylaws of the Corporation, but shall never be less than seven (7)."
- The Company could not produce a formal investment management agreement with Smith Barney Asset Management which had been managing a portion of their investment portfolio since 1998. Discussions with Smith Barney indicated that they had a copy of an agreement in the New York office; however, it was deemed lost in the destruction following the 9/11 disaster. The Company signed a new investment management agreement with Smith Barney Asset Management dated July 7, 2003. The securities managed by Smith Barney continue to be held in custody under the Company's name at National Bank of Commerce.
- The Company did not complete Schedule E – Part 2 – Special Deposits to indicate that a \$100,000 FHLB-5.4%-Due 10/25/06-Cusip 3133MEDP3 was held as a deposit by the State of Tennessee. The security is correctly listed on Schedule D – Part 1. It is suggested that future statements filed with the Department have a properly completed Schedule E in addition to Schedule D as indicated in NAIC Annual Statement Instructions.
- Detail testing of purchases and sales of securities indicate that the Company is recording the settlement date rather than the trade date as the transaction date. The effect of this dating on the Company's amortization of securities as exhibited on Schedule D – Part 1 has an immaterial effect as the time involved is a matter of a few days. No change is proposed to the current Schedule D. It is suggested that the trade date be used as the purchase date on future purchases to better adhere with Statement of Statutory Accounting Principles #26 as stated in the NAIC Accounting Practices and Procedures Manual.

Recommendations:

- The Company's bonds, stocks and short-term investments are managed by investment advisors, Congress Asset Management Company and Salomon Smith Barney. The assets are held in the Company's name at National Bank of Commerce under a Custodial Agreement. The said custodial agreement did not contain the specific requirements outlined in Tenn. Comp. R. & Reg. 0780-1-46.04 as follows:

"An insurance company shall require – in addition to any other provisions – that such a custodial agreement provide a standard of responsibility on the part of the custodian which shall not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee; that securities held by the custodian are subject to instructions of the insurance company; and that securities may be withdrawn immediately upon demand of the insurance company."

National Bank of Commerce and the Company signed an amendment to the above agreement dated July 21, 2003 which complies with Tenn. Comp. R. & Reg. 0780-1-46.04.

The courteous cooperation of the officers and employees of the Company extended during the course of the examination is hereby acknowledged.

In addition to the undersigned, Mr. Brett E. Miller, FCAS, MAAA and Mr. Brian Sewell, Insurance Examiner participated in the work of this examination.

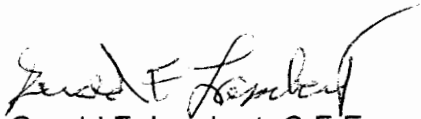
Respectfully submitted,



Keith M. Patterson
Insurance Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.



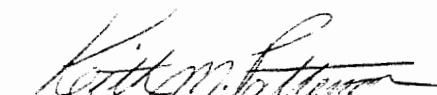
Michael W. Lamb
Insurance Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.



Gerald F. Lambert, C.F.E.
Supervising Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.

AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Paratransit Insurance Company, a Mutual Risk Retention Group dated March 8, 2004, and made as of December 31, 2002, on behalf of the "The Department of Commerce and Insurance", State of Tennessee. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.



Keith M. Patterson
Insurance Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.

Subscribed and sworn to before me

this 8th day of

March, 2004

Notary

Helen W. Dorsey

County

Davidson

State

Tennessee

Commission Expires March 25, 2006